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IN THE

Supreme Court of the United States

October Term, 1949

No. 59

REO MOTORS, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR PETITIONER.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR PETITIONER.

This cause is before this Court for the review on writ of certiorari of a judgment of the United States Court of Appeals for the Sixth Circuit.

The Opinions Delivered in the Courts Below.

The official report of the opinion delivered in the United States Court of Appeals for the Sixth Circuit is reported in 170 F. (2d) 1001.

The official report of the opinion of The Tax Court of the United States is reported in 9 T. C. 314.

The Jurisdiction of this Court.

This Court has jurisdiction to review a judgment of a Court of Appeals by a writ of certiorari granted upon the petition of any party.[1]

[1] Title 28, U. S. Code, Sec. 1254; Sec. 1254, Public Law 773, 80th Congress, Chap. 646, 2nd Session. See page 57 of this brief.

On November 29, 1948 the United States Court of Appeals for the Sixth Circuit ordered and adjudged that the decision of The Tax Court of the United States be affirmed (R. 216). Thereafter petitioner filed a petition for rehearing with said United States Court of Appeals for the Sixth Circuit, and on February 1, 1949 the said Court ordered that said petition for rehearing be overruled (R. 235). On April 25, 1949 petitioner filed in this Court a petition for a writ of certiorari, which petition was granted by this Court on June 6, 1949 (R. 235).

Statement of the Case.

Petitioner, a domestic corporation (Par. First, Stipulation of Facts, R. 54; found as fact, R. 192), in 1941, suffered a loss of $1,551,902.79 (Pars. Twelfth, Fourteenth, Fifteenth, R. 57, 58; found as fact, R. 192) Said loss was allowed in full as a deduction from gross income in determining net income for the taxable year ended December 31, 1941, by Chapter 1 of the Internal Revenue Code (Title 26, United States Code) (R. 193).

In addition to said loss of $1,551,902.79, petitioner in 1941, had other deductions allowed by Chapter 1 of the Internal Revenue Code (Title 26, United States Code) in the amount of $2,215,727.08 (Par. Seventeenth, Stipulation of Facts, R. 58; found as fact, R. 192). Petitioner thus, for 1941, had total deductions allowable by Chapter 1 of the Internal Revenue Code (Title 26, United States Code) of $3,767,629.87.

For 1941, the petitioner had gross income of $2,573,259.89 (Par. Twenty-second, Stipulation of Facts, R. 59; found as fact, R. 192). Petitioner thus, for 1941,[2] had "an excess

[2] The matter in quotation marks is from section 122(a) of the Internal Revenue Code (Title 26, United States Code). See pages 3-4 herein.

of the deductions allowed by * * * Chapter" 1 of the Internal Revenue Code (Title 26, United States Code) "over the gross income" in the amount of $1,194,369.98.

In its income and excess profits tax returns for the taxable year ended December 31, 1942, petitioner claimed as a deduction from its 1942 gross income, pursuant to section 23(s) of the Internal Revenue Code (Title 26, United States Code) (see p. 39), a net operating loss deduction. This claim was made upon the theory that the excess ($1,194,369.98) of 1941 deductions over 1941 gross income was a "net operating loss" within the meaning of section 122(a) of the Internal Revenue Code (Title 26, United States Code) (see pp. 3-4); which resulted in a net operating loss carry-over from 1941 to 1942 under section 122(b) of the Internal Revenue Code (Title 26, United States Code) (see p. 49); and which in turn resulted in a net operating loss deduction within the meaning of section 122(c) of the Internal Revenue Code (Title 26, United States Code) (see p. 50).

The respondent, on the audit of petitioner's income and excess profits tax returns for 1942, disallowed said claim to a net operating loss deduction (Par. Twenty-ninth, Stipulation of Facts, R. 60; found as fact, R. 192). On successive appeals by the petitioner, the respondent was sustained by The Tax Court of the United States (R. 191-201) and by the United States Court of Appeals for the Sixth Circuit (R. 216-223).

Section 122(a) of the Internal Revenue Code (Title 26, United States Code) provides in part:[3]

> *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the ex-

[3] For the convenience of the Court, the full text of section 122(a) is set forth in the Appendix at page 48.

> cess of the deductions allowed by this chapter[4] over the gross income, *with the exceptions, * * * and limitations provided in subsection (d).*[5]

The action of the respondent in disallowing said net operating loss deduction for 1942, and of The Tax Court of the United States and the United States Court of Appeals for the Sixth Circuit in sustaining the respondent, was on the theory that, even though, as we have seen, there was, for 1941, an "excess of the deductions allowed by * * * Chapter" 1 of the Internal Revenue Code (Title 26, United States Code) "over the gross income" in the amount of $1,194,369.98, "the exceptions * * * and limitations provided in subsection (d)" (4) of section 122 of the Internal Revenue Code (Title 26, United States Code) eliminated that excess and thereby eliminated the "net operating loss".

Section 122(d) of the Internal Revenue Code (Title 26, United States Code) as amended by section 105(e) of the Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session), and as that section applied to the taxable year 1942 so far as pertinent[6] provides:

> *Exceptions * * * and Limitations.*—The exceptions, * * *, and limitations referred to in subsection * * * (a) * * * shall be as follows:
>
> * * *
>
> (4) Gains and losses from sales or exchanges of capital assets shall be taken into account without regard to the provisions of section 117(b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains.

---

[4] Chapter 1 of the Internal Revenue Code (Title 26, United States Code).

[5] Italics supplied.

[6] For the convenience of the Court, the full text of section 122(d) as amended by section 105(e) of the Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session) is set forth in the Appendix at page 52.

The first sentence of paragraph (4) of section 122(d) of the Internal Revenue Code (Title 26, United States Code) is of no significance here, since "section 117(b)" is not applicable to corporations (see p. 46). In the case of corporate taxpayers, "gains and losses from sales or exchanges of capital assets" are "taken into account" at one hundred per centum of such gains or losses in any event.

The second sentence of section 122(d)(4), however, is the entire cause of the controversy which we are now presenting to this Court for review, by reason of the following facts:

The loss of $1,551,902.79, described in the first paragraph of this statement of the case, was a long term capital loss under the law applicable to the taxable year ended December 31, 1941 (Par. Sixteenth, Stipulation of Facts, R. 58; found as fact, R. 192). Petitioner realized no capital gains in the taxable year ended December 31, 1941 (Par. Twenty-second, Stipulation of Facts, R. 59; found as fact, R. 192).

Therefore, if the law applicable to the taxable year ended December 31, 1941 governs in determining whether the loss of $1,551,902.79 sustained by the petitioner in 1941 was a loss "from the sale or exchange of capital assets" *within the meaning of section 122(d)(4)* of the Internal Revenue Code (Title 26, United States Code), there was an excess of "losses from sales or exchanges of capital assets" over "the amount includible on account of * * * gains" "from sales or exchanges of capital assets" (section 122(d)(4); see p. 4); there was no "excess of the deductions allowed * * * with the exceptions * * * and limitations provided in subsection (d)" "over gross income" (section 122(a); see pp. 3-4); there was no "net operating loss"; there was no net operating loss carry-over; there was no

net operating loss deduction; in short, the respondent must prevail.

On the other hand, as will be demonstrated in Point I of this brief, the loss of $1,551,902.79, described in the first paragraph of this statement of the case, was not a loss from the sale or exchange of capital assets under the law applicable to the taxable year 1942.

Therefore, if the law applicable to the taxable year 1942 governs in determining whether the loss of $1,551,902.79 sustained by the petitioner in 1941 was a "loss from the sale or exchange of capital assets" *within the meaning of section 122(d)(4)* of the Internal Revenue Code (Title 26, United States Code), section 122(d)(4) has no application; there was an "excess of the deductions allowed * * * over the gross income" (section 122(a); see pp. 3-4) amounting to $1,194,369.98; there was a "net operating loss" of $1,194,369.98; there was a net operating loss carry-over; there was a net operating loss deduction; in short, the petitioner must prevail.

A Specification of Such of the Assigned Errors As Are Intended to Be Urged.

It is intended that each of the errors assigned on pages 11 and 12 of petitioner's petition herein for writ of certiorari and brief in support thereof will be urged.

Summary of the Argument.

The loss of $1,551,902.[illegible] suffered by the petitioner in 1941 was not a loss from the sale or exchange of capital assets under the law applicable to the taxable year 1942.

Petitioner and Reo Sales Corporation were affiliated, and therefore the worthlessness of the stock of the latter was an ordinary loss.

The law applicable to the taxable year 1942 governs in determining whether the loss sustained by the petitioner in 1941 was a "loss from the sale of capital assets" within the meaning of section 122(d)(4) of the Internal Revenue Code (Title 26, United States Code). The governing law is to be determined in accordance with the intention of Congress. That Congress so intended is indicated by: (1) Congress must have intended to give the same meaning to the term "capital asset" in sections 123(a) and 150(e) of the Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session). (2) If the law applicable to 1942 does not govern, then Congress is in the position of having used the term "capital assets" in section 122(d)(4) with one meaning for the purposes of section 122(a), another meaning for the purposes of section 122(b), and still another meaning for the purposes of section 122(c). (3) The 1942 law governs in determining whether a loss shall be eliminated in determining 1942 tax liability. (4) Congress has, in every instance in which it has been its will that a factor entering into the determination of tax liability (when such factor depends upon events occurring outside the taxable year) should be interpreted in accordance with the law applicable to the year of the event rather than to the year of tax liability, specifically so provided; it has not done so here. (5) The report of the Senate Finance Committee on the Revenue Bill of 1942 indicates that it was the intention of Congress that the law applicable to 1942 should govern.

The Court below erred in its conclusions based upon the effective date of the amendment by which paragraph (4) was added to section 23(g) of the Internal Revenue Code.

THE ARGUMENT.

I.

The loss of $1,551,902.79, suffered by the petitioner in 1941, was not a loss from the sale or exchange of capital assets under the law applicable to the taxable year 1942.

It was stipulated by the parties that the loss of $1,551,902.79 was "a long term capital loss under the law applicable to the taxable year ended December 31, 1941" (R. 58).

Section 117(a)(5) of the Internal Revenue Code (Title 26, United States Code), as that section applied to the taxable year 1941, reads, so far as pertinent,[7] as follows:

> *Definitions.*—As used in this chapter[8]
>
> * * *
>
> (5) *Long Term Capital Loss.*—The term "long term capital loss" means loss from the sale or exchange of a capital asset.
>
> * * *

While the loss arose *with respect to* a "capital asset", within the meaning of section 117(a)(1) of the Internal Revenue Code (Title 26, United States Code) (see p. 45), as that section applied to the taxable year 1941, it did not result from a "sale or exchange". It resulted, on the contrary, from the worthlessness of stock (Pars. Fourteenth, Fifteenth and Eighteenth, Stipulation of Facts, R. 58; found as fact, R. 192; see first sentence of opinion of Judge HILL in The Tax Court of The United States, R. 195).

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[7] For the convenience of the Court the full text of section 117(a)(5), as that section applied to the taxable year 1941, is set forth in the Appendix at page 45.

[8] Chapter 1 of the Internal Revenue Code (Title 26, United States Code).

The stipulated fact, therefore, was not based on section 117 of the Internal Revenue Code (Title 26, United States Code). It was based on section 23(g)(2) of the Internal Revenue Code (Title 26, United States Code), as that section applied to the taxable year 1941:

> (g) *Capital losses.*—
>
> • • •
>
> (2) *Securities becoming worthless.*—If any securities (as defined in paragraph (3) of this subsection) become worthless during the taxable year and are capital assets, the loss resulting therefrom shall, for the purposes of this chapter, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.
>
> (3) *Definition of securities.*—As used in this subsection the term "securities" means (A) shares of stock in a corporation, and (B) rights to subscribe for or to receive such shares.

Section 123(a)(1) of the Revenue Act of 1942 (Public Act No. 753, 77th Congress, 2nd Session) amended section 23(g) of the Internal Revenue Code (Title 26, United States Code) by adding thereto a new paragraph (4), as follows:

> (4) *Stock in affiliated corporation.*— For the purposes of paragraph (2) stock in a corporation affiliated with the taxpayer shall not be deemed a capital asset. For the purposes of this paragraph a corporation shall be deemed to be affiliated with the taxpayer only if:
>
> (A) at least 95 per centum of each class of its stock is owned directly by the taxpayer; and
>
> (B) more than 90 per centum of the aggregate of its gross incomes for all taxable years has been

from sources other than royalties, rents, dividends, interest, annuities, or gains from sales or exchanges of stocks and securities; and

(C) the taxpayer is a domestic corporation.

Section 101 of the Revenue Act of 1942 (Public Law No. 773, 77th Congress, 2nd Session) (see pp. 14-15) made the addition of paragraph (4) to section 23(g) effective with respect to taxable years beginning after December 31, 1941.

Since all (not merely 95 per centum of each class) of the stock which became worthless was owned directly by the petitioner (Par. Twelfth, Stipulation of Facts, R. 57; found as fact, R. 192); since more than 90 per centum of the gross income for all taxable years of Reo Sales Corporation (the corporation whose stock became worthless), was from sources other than royalties, rents, dividends, interest, annuities, or gains from sales of stock and securities (Par. Thirteenth, Stipulation of Facts, R. 57; found as fact, R. 192); and since the petitioner is a domestic corporation (Par. First, Stipulation of Facts, R. 54; found as fact, R. 192), petitioner and said Reo Sales Corporation were affiliated.

And since petitioner and said Reo Sales Corporation were affiliated, the loss of $1,551,902.79 suffered by the petitioner in 1941, was not a loss from the sale or exchange of capital assets under the law applicable to the taxable year 1942.

II.

The law applicable to the taxable year 1942 governs in determining whether the loss sustained by the petitioner in 1941 was a "loss from the sale or exchange of capital assets" within the meaning of section 122(d)(4) of the Internal Revenue Code (Title 26, United States Code).

A. The governing law is to be determined in accordance with the intention of Congress.

We will not trouble to cite cases in support of this proposition. All the law with respect to the income tax and excess profits tax is the creature of Congress. We anticipate no attempt to rebut the principle that the governing law is to be determined in accordance with the intention of the legislature.

B. The intention of Congress is indicated by the fact that in both section 123(a) and section 150(e) of the Revenue Act of 1942 Congress used the term "capital assets"; unless it intended the law applicable to 1942 to govern, the term means one thing in section 123(a) and an utterly different thing in section 150(e).

We have heretofore pointed out (p. 9) that section 123(a) of the Revenue Act of 1942 (Public Act No. 753, 77th Congress, 2nd Session) added paragraph (4) to section 23(g) of the Internal Revenue Code *with respect to taxable years beginning after December 31, 1941.* Said paragraph (4) provided that the stock of an affiliated corporation, which had become worthless, should not be "*for the purposes of this chapter*" (*i. e.*, Chapter 1 of the Internal Revenue Code (Title 26, United States Code)) a "*capital asset*". (See section 23(g)(2), page 9.)

By the same Revenue Act of 1942, in section 150(e), section 122(d)(4) was amended, for the taxable years beginning after December 31, 1941, to refer to gains and losses from sales or exchanges of "*capital assets*".

If the decision of the Court below is correct, Congress in section 123(a) of the Revenue Act of 1942 meant to define "*capital assets*" so as to *exclude* the worthless stock of an affiliated corporation; and at the same time *and for the same taxable year* meant in section 150(e) of the same statute to define "*capital assets*" to *include* the worthless stock of an affiliated corporation.

We submit that it is inconceivable that Congress should have thus used the *same term, in the same statute, and with respect to the same period*, with such opposite meanings.

C. If the law applicable to 1942 does not govern, then the term "loss from the sale of capital assets" in section 122(d)(4) may have one meaning for the purposes of section 122(a), another meaning for the purposes of section 122(b), and still a third meaning for the purposes of section 122(c).

On the theory upon which this case was decided in the courts below, a net operating loss is governed by the law applicable to the year in which the loss occurred; the net income of "a second preceding taxable year" (in the case of a net operating-loss carry-back; section 122(b)(1)) is to be determined by the law applicable to such second preceding taxable year; the net income for any "intervening taxable year" and the net income for "the two years preceding the taxable year" is to be determined by law applicable to such "intervening taxable year" and such "two preceding taxable years" (section 122(b)(2)); and the net income of the taxable year is to be determined by the law applicable to the taxable year (section 122(c)); the governing law in each of these cases might well define a capital asset in a different way.

We submit that it is inconceivable that Congress intended, in enacting section 122(d)(4) that so many different meanings should or might be given to the single phrase "gains and losses from the sale or exchange of capital assets".

D. The loss which the petitioner sustained in 1941 was allowable in full under the laws applicable to both 1941 and 1942 and the 1942 law must apply in determining whether such allowable loss shall be eliminated in determining a 1942 net loss deduction.

The loss which the petitioner sustained in the year 1941 on the worthlessness of the stock of Reo Sales Corporation was allowable in full and without limitation in the computation of its net income for 1941 under the provisions of the Internal Revenue Code applicable to that year. Similarly, if such loss had occurred in the year 1942, the loss would have been deductible in full and without limitation in the computation of petitioner's tax liability for the year 1942 under the provisions of the Internal Revenue Code applicable to the year 1942. This is, therefore, *not* a case involving a deduction allowable under the law applicable to one year but not allowable under the law applicable to the other year. This case, hence, does not involve the issue as to whether a deduction not allowable under the 1941 law, but allowable under the law applicable to 1942, may be included in determining the net operating loss deduction for 1942; or whether a deduction allowable under the 1941 law, but not allowable under the law applicable to 1942, may be included in determining the net operating loss deduction for 1942.

The *sole* issue presented for decision in this case, and the only question requiring decision, is whether the loss sustained in 1941 and clearly allowable in full and without limitation under the laws applicable to both 1941 and 1942

must be eliminated in computing the amount of the net loss deduction to which the petitioner is entitled for the year 1942.

The only possible basis for a contention that the loss otherwise allowable must be eliminated in the computation of the amount of the net loss deduction is that such elimination is required as one of the "exceptions, additions and limitations provided in subsection (d)" of section 122 of the Internal Revenue Code. Of the exceptions, additions and limitations provided in subsection (d) of section 122, the only one which could have any possible application is that appearing in subparagraph (4) of section 122(d) dealing with gains and losses from the sales or exchanges of capital assets. Section 122(d)(4) of the Internal Revenue Code was amended by the Revenue Act of 1942. Before amendment, it provided:

> Long-term capital gains and long-term capital losses shall be taken into account without regard to the provisions of section 117(b). As so computed the amount deductible on account of long-term capital losses shall not exceed the amount includible on account of the long-term capital gains, and the amount deductible on account of short-term capital losses shall not exceed the amount includible on account of short-term capital gains.

Section 150(e) of the Revenue Act of 1942 amended section 122(d)(4) to read as set forth below:

> Gains and losses from sales or exchanges of capital assets shall be taken into account without regard to section 117(b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains;

Section 101 of the Revenue Act of 1942 provides:

> Except as otherwise expressly provided, the amendments made by this title shall be applicable

only with respect to taxable years beginning after December 31, 1941.

Neither section 123(a) of the Revenue Act of 1942 which added subparagraph (4) to section 23(g) of the Internal Revenue Code nor section 150(e) of the Revenue Act of 1942 amending section 122(d)(4) of the Internal Revenue Code contains any provisions with respect to the effective date thereof. Consequently, both sections were subject to section 101 of the Revenue Act of 1942, and by that section made "applicable only with respect to taxable years beginning after December 31, 1941".

Regardless of the arguments which may be made to support the proposition that a deduction not allowable under the law applicable to the year 1941 may not be allowable in the computation of the net operating loss deduction for the year 1942 even if allowable under the 1942 law, there can be no rational basis for contending that a loss allowable for the year 1941 must be eliminated in the computation of the net operating loss deduction for the year 1942 unless such elimination is required by the provisions of the law applicable to the year 1942.

Petitioner concedes that if it were claiming a net operating loss deduction to be allowed in the year *1941*, the loss in question would be eliminated in the computation of the net operating loss deduction. But, the petitioner is *not* claiming a net operating loss deduction for the year 1941. Obviously, a loss occurring in the year 1941 cannot result in a net operating loss deduction allowable for the year 1941 since the net operating loss deduction by its very nature is dependent upon the losses of some other taxable period. Consequently, the provisions of section 122 of the Internal Revenue Code are purely academic in the year 1941 when the excess of the deductions over the gross income actually occurred. It is only when the taxpayer

endeavors to carry over such excess of deductions over the gross income to some other year that the operation of section 122(d) comes into play, and it is necessary to determine the extent to which such excess of deductions over gross income in the year 1941 may be carried over and allowed as a deduction in the computation of the taxpayer's 1942 tax liability. We submit that there is absolutely no basis in reason for looking at the 1941 law to determine to what extent the excess of deductions over gross income would have resulted in a net loss deduction allowable in the year 1941 when no such deduction is claimed for the year 1941, and it is obvious that the excess of deductions over gross income for 1941 could not, under any possible circumstances, also result in a net operating loss deduction for 1941. The taxpayer clearly had an excess of deductions over gross income in 1941 which it is claiming as a deduction for 1942; it follows, we submit, that whether such excess of deductions over gross income is allowable in 1942, and the adjustments, if any, which should be made therein in determining the amount allowable, must be determined by the law applicable to the year 1942.

Having determined that there was an excess of deductions allowable for the year 1941 over the gross income for that year in the identical amount, regardless of whether the law applicable to the year 1941 or the year 1942 is considered determinative, the only other question in this case is whether one of the deductions resulting in the excess of deductions over gross income must be eliminated in determining the amount of the net loss deduction allowable for the year 1942. The petitioner submits that section 122(d)(4) of the Internal Revenue Code, as amended by section 150(c) of the Revenue Act of 1942, does not require any reduction whatsoever in the excess of the deductions over the gross income for 1941 which is allowable as a net

operating loss deduction for the year 1942. The fundamental error of the respondent and the courts below is in concluding that section 122(d)(4), as amended, requires the elimination of the loss in question since such loss was a capital loss in 1941 and the section states that gains and losses from sales or exchanges of capital assets shall be taken into account without regard to section 117(b), and that, as so computed, the amount deductible on account of such losses shall not exceed the amount includible on account of such gains. That error is the result of a failure to consider the meaning of the phrase "gains and losses from sales or exchanges of capital assets" as used in section 122(d)(4) as amended.

The terms "long-term capital gains", "long-term capital losses", "short-term capital losses", "short-term capital gains" and "gains and losses from sales or exchanges of capital assets" are given specific definitions in the Internal Revenue Code (sections 23(g) and 117). Consequently, when these words are used in the statute, they must be given the well defined meaning which Congress has assigned to them (*Fox* v. *Standard Oil Co.*, 294 U. S. 87 [9]). By section 123(a) of the Revenue Act of 1942 amend-

[9] "* * * * There might be force in this suggestion if the statute had left the meaning of its terms to the test of popular understanding. Instead, it has attempted to secure precision and certainty by rejecting a test so fluid and indeterminate and supplying its own glossary. The goods offered for sale are to be understood as having reference to goods 'of any kind', and the place at which the sale is made shall include not only places that in the common speech of men would be designated as stores, but, broadly speaking, any mercantile establishment, whether a store or something else. In such circumstances definition by the average man or even by the ordinary dictionary with its studied enumeration of subtle shades of meaning is not a substitute for the definition set before us by the lawmakers with instructions to apply it to the exclusion of all others. Cf. Midwestern Petroleum Corp. v. State Tax Comrs., 206 Ind. 688, 187 N. E. 882. There would be little use in such a glossary if we were free in despite of it to choose a meaning for ourselves." (*Fox* v. *Standard Oil Co.*, 294 U. S. 87, 95.)

ing section 23(g) of the Internal Revenue Code, Congress specifically provided that stock in an affiliated corporation (as there defined) shall not constitute a capital asset. It is inescapable therefore, we submit, that when in section 150(e) of the same Revenue Act of 1942 (amending section 122(d)(4) of the Code) Congress used the term "capital assets", it intended that that term did not include stock in an affiliated corporation. Where a term has once been defined, it is unnecessary to repeat that definition whenever such term is again used in the statute; the use of the term itself is equivalent to a repetition of the definition. Section 23(g)(2) of the Internal Revenue Code, to which section 23(g)(4) specifically relates, sets forth a rule "for the purposes of this chapter". Since section 122 of the Internal Revenue Code is a part of the same chapter, the definition in section 23(g)(4) necessarily applies to section 122(d)(4). If we eliminate in section 122(d)(4), as amended, the words of art "capital assets" and substitute therefor the actual definition of capital assets, we will find that stock in an affiliated corporation is not included within the definition. The result is that there is nothing in the law adopted by Congress in 1942 and made applicable with respect to years beginning after December 31, 1941 which provides that in computing 1942 tax liability losses on the worthlessness of stock in an affiliated corporation "shall not exceed the amount includible on account of" gain from the sales or exchanges of capital assets.

It is clear, therefore, we submit, that if in determining 1942 tax liability the exceptions, additions and limitations required to be made in determining the amount of the 1942 deduction must be computed in accordance with the provisions of the Internal Revenue Code specifically made applicable with respect to the year 1942, section 122(d)(4)

of the Internal Revenue Code as it existed in 1942, and not as it existed in some prior year, must be applied. If section 122(d)(4) of the Internal Revenue Code, as it existed in 1942, is applied in this case, it will follow automatically that the deduction which the petitioner has claimed is proper and allowable.

In *Moore, Inc.* v. *Commissioner* (4 T. C. 404, aff'd 151 F. (2d) 527), the specific question involved was whether section 122(d)(4) of the Internal Revenue Code as it existed in 1942, or as it existed in 1941, was to be applied in computing the taxpayer's tax liability for the year 1942. Both The Tax Court of the United States and the United States Court of Appeals for the Fifth Circuit held that section 122(d)(4) of the Internal Revenue Code as it existed in 1942 was to be applied. In its opinion in the instant case (9 T. C. 314; R. 191), the Tax Court did not overrule its decision in the *Moore, Inc.* case but based its decision on a purported distinction which the respondent admits is without foundation. The decision of the Tax Court in *Cambria Collieries Co.* v. *Com'r* (10 T. C. 1172), is not inconsistent with the *Moore, Inc.* case. In the *Cambria Collieries Co.* case, there was not involved the question of an adjustment under section 122(d), but a situation where a deduction was allowable under the law applicable to one year but not under the law applicable to another year. That case is, therefore, distinguishable from both this case and the *Moore, Inc.* case. That the Tax Court has never abandoned the *Moore, Inc.* case nor the basic principles upon which it was decided is evidenced by its decision in *Community Public Service Company* v. *Com'r* (12 T. C. #118), in which the *Moore, Inc.* case was cited with approval, and it was declared that "the Moore case is in principle applicable here".

E. The intention of Congress is clearly indicated by the fact that in every instance in which it has been the will of the legislature that a factor entering into the determination of tax liability (when such factor depends upon events occurring outside the taxable year), should be interpreted in accordance with the law applicable to the year of the event rather than to the year of tax liability, Congress has clearly so provided.

This case involves corporate income taxes and corporate excess profits taxes for the calendar year 1942, imposed by Chapters 1 and 2, respectively of the Internal Revenue Code (Title 26, United States Code). Each of these taxes is measured by the net income, as defined by the Code, for, in the instant case, the calendar year 1942. Net income is the excess of gross income over the deductions allowed. (Section 21 Internal Revenue Code (Title 26, United States Code); see p. 39 herein.)

Most of the factors which enter into the determination of net income are the result of events occurring within the taxable year. Whether a given item of gross income is gross income for 1942 depends upon whether it was received in 1942 or whether the event which caused it to be accrued occurred in 1942. Whether a given expense is a deduction of 1942 depends upon whether it was paid in 1942 or upon whether the event which caused it to be accrued occurred in 1942.

There are, however, many factors entering into the determination of net income which are the result of events which do not occur within the taxable year.

For example, property which is sold at a profit or a loss within the taxable year may have been acquired in a prior year. The circumstances of acquisition are factors entering into the determination of net income which depend

upon events occurring outside the taxable year. Again, in the taxable year it is necessary to take into consideration in the taxable year a part of the income from an installment sale made in a prior year (see section 44(a), Internal Revenue Code (Title 26, United States Code); p. 39 herein). The sale is an event not occurring in the taxable year. Many other such illustrations might be given.

The net operating loss deduction here in question is such a factor, depending upon events occurring outside the taxable year.

Congress has consistently and regularly, whenever its intention has been that such a factor should be determined by the law applicable to the year of the event, rather than to the year of the tax liability, specifically so provided. There are more illustrations of this in the revenue laws than space or time will permit us to specify, but the following should suffice.

As pointed out in the opinion of The Tax Court in the *Moore, Inc.* case (4 T. C. 404, 406), the Revenue Acts of 1924, 1926, 1928 and 1932 each contained a provision to the effect that the net loss to be carried forward from one year to a succeeding taxable year was to be computed under the law applicable to the earlier year. The provisions of the Revenue Act of 1932 permitting the net loss deduction was repealed as of January 1, 1933 by section 218(a) of the National Industrial Recovery Act (June 16, 1933).

When, after a lapse of six years, Congress reinstituted the principle of the carry-over of a net loss as a deduction in a subsequent year, the Internal Revenue Code was amended by section 211(b) of the Act of June 29, 1939 by the additions of sections 23(s) and 122. It is apparent that the language of the prior revenue acts was borrowed liberally in section 122. However, the provisions of the prior

acts to the effect that the law applicable to the prior year was to be applied in determining the amount of the net loss to be carried forward were omitted. This omission was taken by The Tax Court in its opinion in the *Moore* case as an indication that Congress did not intend to have the law of the prior year apply, a position supported by the familiar principle that some significance must be attached to the omission of words in the reenactment of a statute. As was said in *Pirie* v. *Chicago Title & Trust Co.* (182 U. S. 438, 448):

> "The words in italics are omitted from the act of 1898. Was the omission without purpose? The omission of a condition is certainly not the same thing as the expression of a condition. Was it left out in words to be put back by construction? Taken from the certainty given by prior use and prior decisions, and committed to doubt and controversy? There is a presumption against it When the purpose of a prior law is continued, usually its words are, and an omission of the words implies an omission of the purpose This rule we lately applied in *Bardes* v. *First Nat. Bank*, 178 U. S. 524, 44 L. ed. 1175, 20 Sup. Ct. Rep. 1000. In that case, in determining whether the jurisdiction of the circuit and district courts of the United States was concurrent with the state courts in certain suits at law and equity between the assignee in bankruptcy and the adverse claimant of property of the bankrupt, the statutes of 1841 and 1867 were compared with that of 1898, and from the omission from the latter of certain provisions of the former statutes it was decided that such jurisdiction did not exist. It was said by the court, speaking by Mr. Justice GRAY: 'We find it impossible to infer that when Congress, in framing the act of 1898, entirely omitted any similar provision, and substituted the restricted provisions of § 23, it intended that either of those courts should retain the jurisdiction which it had under the obsolete provision of the earlier acts.'"

The fact that Congress in other provisions of the Internal Revenue Code has made it clear when the provisions of prior law are to control is an indication that Congress had no such intention in the present case. For example, section 113(a)(3) of the Internal Revnue Code provides:

> The basis of property shall be the cost of such property; except that—
>
> • • • • • • •
>
> (3) Transfer In Trust After December 31, 1920.—If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a gift, bequest, or devise) the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer *under the law applicable to the year in which the transfer was made*. (Italics supplied.)

Language similar to the italicized portion of section 113 (a)(3) as quoted above will be found in subsections (a)(5), (6), (7), (8), (9) and (13) of section 113 of the Internal Revenue Code.

The above are a few of the many instances in which Congress has expressed its intention that the law applicable to the year of an event occurring outside the taxable year shall govern the determination of income.

On the other hand, there have been situations in which Congress, by remaining silent as to the applicable law, has indicated an intention that the law of the year for which the liability is being ascertained, is to govern.

A familiar situation in which a transaction occurring in one taxable year affects the tax liability of a future taxable year is where a taxpayer sells property on the installment plan and in accordance with the provisions of section 44 of the Internal Revenue Code elects to report his profit

on the installment basis. The sale may or may not have constituted the sale or exchange of a capital asset under the law applicable to the year of sale. However, the character of the income, whether capital gain or ordinary income, to be reported with respect to such sale in a subsequent year is governed by the law in effect during such subsequent year and not by the law in effect during the year of sale. (*Snell* v. *Com'r*, 97 F. (2d) 891; *Hay* v. *Com'r*, 25 B. T. A. 96; Example I of Section 29.117-7 of Regulations 111.) [10]

The Court below dismissed the argument based upon the *Snell* and *Hay* cases and Section 29.117-7 of Regulations 111 by the observation (R. 222) that "such subsequent installment payments are properly governed by the law of the year in which received. The Regulation deals with a situation entirely different from the one here involved". We submit that the two situations are not entirely different. In both cases, there is a transaction in one year which affects the tax liability of a subsequent year. In the one case, the taxpayer sells property at a profit which need not be included in full in income in the year of sale but may be deferred to a future period. In the other case, a loss is sustained which, with the other deductions allowable, exceeds the net income for the year of loss and the question is the carry-over of such loss to the succeeding year. If, in the one case, the character of the income to be included in the later year is to be determined by whether the law of the later year defines the property

[10] Section 151(b) of the Revenue Act of 1942 added subsection (j) to section 117 of the Internal Revenue Code and by section 101 of the Revenue Act of 1942 (the identical section applicable to the amendments to sections 122(d) and 23(g)(4) of the Code) the amendment was made "applicable only with respect to taxable years beginning after December 31, 1941". The example of the Regulations cited shows that in the case of a sale in 1941 (not resulting in a capital gain under the law applicable to that year) the profit to be reported in 1942 may be reported as a capital gain under section 117(j).

sold in the earlier year as a capital asset, why should not the character of the loss to be carried over to the later year likewise be determined by the law applicable to the later year? In each case, the transaction giving rise to the gain or loss occurred in the prior year and did, or did not, constitute a sale or exchange of a capital asset under the law applicable to such earlier year. However, in neither case are we concerned with the taxpayer's tax liability for the earlier year. We submit that in both cases the taxpayer's tax liability for the later year must be determined in accordance with the provisions of law made applicable "with respect to" the later year and not by what the law may have provided in the earlier period, and that this is particularly so where the only question, as in this case, is whether the current law requires that the loss in the prior year shall or shall not be eliminated in computing the current year's net operating loss deduction.

Other cases in which the courts have held that, in the absence of clearly indicated Congressional intent to the contrary, a factor entering into the determination of tax liability for one year but dependent upon events occurring outside the taxable year is to be interpreted in the light of the law applicable to the year for which tax liability is being determined, are:

Community Public Service Company v. *Commissioner* (12 T. C. No. 118, decided May 31, 1949) in which it was held that unused excess profits tax credit carry-overs from 1941 and 1942 to 1943 (dependent upon events occurring in years other than 1943) were to be computed under the law applicable to 1943—the year for which tax liability was being determined.

Forstmann v. *Rogers* (128 F. (2d) 126 United States Circuit Court of Appeals for the Third Circuit) in which the basis of property acquired in 1922 and sold in 1928 was

determined in accordance with the law applicable to 1928, the year of sale, and not under the law applicable to 1922, the year of the event.

In *Döckendorff* v. *The United States* (84 Fed. Supp. 372) decided by the Court of Claims on June 6, 1949, the fiscal year of a partnership was from October 1, 1941, to September 30, 1942. On October 17, 1941, it realized gains which, if the law applicable to 1941 were applied, constituted ordinary income. Under law applicable to 1942, however, such gains were capital gains. It was held, in the case of a partner, that for the purpose of determining his liability for the calendar year 1942 (in which year he was required to report his share of the partnership profits for said fiscal year) the law applicable to 1942 should govern—not the law applicable to the time when the event, the sale, occurred.

F. The report of the Senate Finance Committee on the Revenue Bill of 1942 demonstrates that it was the intention of Congress that the law applicable to the year of tax liability should govern.

The correctness of the position contended for by the petitioner here and adopted by The Tax Court of the United States and the United States Court of Appeals for the Fifth Circuit in the *Moore, Inc.* case is demonstrated by the Report of the Senate Finance Committee on the Revenue Bill of 1942. The Senate Finance Committee proposed an amendment to the Revenue Bill of 1942 as passed by the House. Section 155 of the Senate Finance Committee Bill (section 153 of the Bill as finally enacted) amended, among other things, section 122(b) of the Internal Revenue Code to provide for a different definition of a net operating loss carry-over than had theretofore been contained in the Code. The amendments proposed by the Committee were expressly made applicable only to taxable years beginning after December 31, 1940. In its Report with respect to this

amendment, the Senate Finance Committee stated (Senate Report No. 1631, 77th Congress, Second Session, p. 123; Cumulative Bulletin 1942-2, p. 596):

> "The net operating loss deduction for any taxable year is the sum of the carry-backs and the carry-overs to such taxable year. The amendments made by this section *are applicable to all taxable years beginning after December 31, 1940.* Thus, in the case of a taxpayer on the calendar year basis, *the carry-overs to the taxable year 1941 from the taxable years 1939 and 1940*, and the carry-backs to such taxable year from the taxable years 1942 and 1943 *will be determined under the amendments made by this section.*" (Italics supplied.)

Thus, there was a specific recognition by the Congressional Committee that the amendment although applicable only "to all taxable years beginning after December 31, 1940" would be effective in determining the carry-overs to the taxable year 1941 from the taxable years 1939 and 1940. The Court below (R. 221) completely misconceived the significance of this Report. Section 153 of the Revenue Act of 1942 did *not* merely add a provision permitting net operating loss carry-backs. Subsection (b) of that section did amend the prior law to permit carry-backs as well as carry-overs. However, subsection (a) of the section deals with the manner of computing the *amount* of a carry-back or carry-over. Under section 153(c) of the Revenue Act of 1942 amending section 122(e) of the Code, no carry-back is permitted to years prior to 1941. Accordingly, the amount of any carry-overs from 1939 and 1940 to 1941 could not in any way be influenced by carry-backs from subsequent years. It is obvious, therefore, that when the Committee referred to carry-overs from 1939 and 1940 to 1941 being determined under the amendments, it was *not* referring to the amendments effected by section 153(b) of the Revenue Act of 1942 providing for carry-backs.

As mentioned above, subsection (a) of section 153 of the Revenue Act of 1942 deals with the manner of computing the amount of carry-overs and carry-backs. Subsection (b) of section 122 of the Internal Revenue Code, as it previously existed, was amended by being subdivided into two subparagraphs, subparagraph (1) being concerned with net operating loss carry-backs and subparagraph (2) being concerned with net operating loss carry-overs. In this connection, the Senate Finance Committee (Senate Report No. 1631, 77th Congress, Second Session, p. 122; Cumulative Bulletin 1942-2, p. 596) said:

> "The *amount* which may be carried back or carried forward is limited in the case of each such preceding or succeeding year to the amount which was not used to offset income for any taxable years before such preceding or succeeding year. In determining the *amount* of the net operating loss which is so used to offset income in any taxable year, the net income for such taxable year is computed without the deduction of any carry-over or carry-back from the year in which the net operating loss arose or from any year subsequent thereto *but with certain other adjustments now required under section 122(d)*. The net operating loss which is a carry-over or a carry-back to such taxable year is considered to have been applied against the net income so computed." (Italics supplied.)

As stated by the Senate Finance Committee, the amount of a net loss must be reduced by the amount of the net income of an intervening year "but with certain other adjustments *now* required under section 122(d)".[11] Obviously, the Committee was referring to that part of section 122(b)(2), as amended by section 153(a) of the Revenue Act of 1942, providing that the amount of a net operating loss should be reduced by the amount of the income of the intervening taxable year computed "with the exceptions, additions, and

[11] Italics supplied.

limitations provided in subsection (d)(1), (2), (4), and (6)".

A comparison of section 122(b) before and after amendment (see p. 49 herein) shows that the amended section requires an adjustment under section 122(d)(6), whereas, no such adjustment was required before amendment.

The Senate Finance Committee did not state merely that in computing income for a year beginning after December 31, 1940 the net loss deduction would be the sum of carry-backs and carry-overs. It went on to say that such carry-backs and carry-overs "will be determined under the amendments made by this section" specifically stating that any carry-overs to the taxable year 1941 from the taxable years 1939 and 1940 would be determined under the amendment.

When in section 153 of the Revenue Act of 1942 Congress amended the method of computing net loss carry-overs and provided that the amendments effected by that section would be applicable only to taxable years beginning after December 31, 1940 and the Senate Finance Committee specifically stated that the carry-overs to the taxable year 1941 from the taxable years 1939 and 1940 would be determined under the amendments, there was a clear recognition that making the amendments applicable to the year 1941 was making the amendments applicable in the computation of tax liability for the year 1941.

Further, the position taken by the Senate Finance Committee is diametrically opposed to the position upon which the respondent has built the foundation for his entire argument. The basic premise upon which the respondent has argued this case is that the amount of the net operating loss is determined by reference to the law applicable to the year of loss, the net operating loss carry-over by reference to the law applicable to the intervening year and only the

net operating loss deduction itself by the law applicable to the year of deduction. Thus, the effect of respondent's argument is that in determining whether a taxpayer is entitled to take a net operating loss deduction in 1941 by reason of a net loss in 1939, the net operating loss is to be computed under the law applicable to 1939, the net operating loss carry-over under the law applicable to 1940 and only the adjustments thereto to determine a net operating loss deduction under the law applicable to 1941. Yet, the Senate Finance Committee stated that such was not the case. It stated that the net operating loss carry-over was to be determined by an amendment applicable only to 1941 and subsequent years, that is, that the law applicable to 1941, and not the law applicable to 1940, was to govern the determination of the net operating loss carry-over. Thus, the foundation itself for the respondent's argument is removed.

We believe that we have demonstrated that it was the intention of Congress that the law applicable to the year 1942 governs in determining whether the loss sustained by the petitioner in 1941 was a "loss from the sale or exchange of capital assets" within the meaning of section 122(d)(4) of the Internal Revenue Code (Title 26, United States Code).

III.

The Court below erred in its conclusions based upon the effective date of the amendment by which paragraph (4) was added to section 23(g) of the Internal Revenue Code (Title 26, United States Code).

The Court below, for all practical purposes, bases its decision on the fact that the addition of paragraph (4) to section 23(g) was effective only for the taxable year 1942 and subsequent years.

We submit that all that is here involved is the tax liability for 1942. That liability is dependent upon an event which occurred in 1941. The fact remains that it is 1942 tax liability that is being determined, and the events of other years, in the absence of clearly expressed Congressional intent to the contrary are to be interpreted in the light of the law applicable to 1942.

The basis upon which The Tax Court of the United States decided the *Moore, Inc.* case is clearly set forth in its opinion as follows (4 T. C. 404, 406):

> "Section 101 of 'Title I—Individual and Corporation Income Taxes' of the Revenue Act of 1942 bears the subtitle 'Taxable Years to Which Amendments Applicable.' It reads: 'Except as otherwise expressly provided, the amendments made by this title shall be applicable only with respect to taxable years beginning after December 31, 1941.'
>
> "Section 150(e) of the Revenue Act of 1942, *supra*, amending subsection (d)(4) of section 122 of the Internal Revenue Code, contains no express provision as to the time that amendment is to become effective.
>
> "Certainly, in its present context, 'with respect to' could mean nothing less than 'in computing a tax liability for.' Thus, paraphrasing section 101, *supra*, section 122(d)(4) of the Internal Revenue Code, as amended by section 150(e) of the Revenue Act of 1942, the provision would read 'shall be applicable • • • in computing a tax liability for taxable years beginning after December 31, 1941.' The question here is the tax liability of petitioner for such a year —the calendar year 1942. The answer to that question requires the use of a formula to compute the amount of the net operating loss for 1941. But the use of that formula has nothing to do with a tax liability for 1941. Its use here is limited to the determination of the tax liability of petitioner for the calendar year 1942.

> "We conclude, therefore, that the 'net operating loss' of petitioner for 1941, to be used in the computation of its net operating loss carry-over to the calendar year 1942 for determining its net income and taxes for that latter year, shall be computed under section 122(d)(4) of the Internal Revenue Code, as amended by section 150(e) of the Revenue Act of 1942."

The identical reasoning was adopted in the opinion of the United States Court of Appeals for the Fifth Circuit in which it was said (151 F. (2d) 527, 528):

> "And we are not left to conjecture as to when the amendment was to become effective, for the amending Act, at the beginning of Part I, Title 1, which consists of amendments to the Revenue Code, declares in Sect. 101, 56 Stat. 802, 26 U. S. C. A. Int. Rev. Acts, 'Except as otherwise expressly provided, the amendments made by this title shall be applicable only with respect to taxable years beginning after December 31, 1941.' There is no 'otherwise' provision. So this amendment applies with respect to taxable years beginning after December 31, 1941. It therefore applies with respect to the taxable year 1942. It is with respect to taxation for that year that the carry-over produced by a capital loss is here claimed as a deduction; and to ascertain what if anything is deductible by way of carry-over from 1941, we think, as did the Tax Court, that by the express words of the amended Section 122(d)(4), 'gains and losses from sales or exchanges of capital assets shall be taken into account' without any reference to what sort of result would have been figured out in 1941 under the then law. * * * "

In the instant case, the United States Court of Appeals for the Sixth Circuit has adopted a directly contrary view. It is stated in the opinion of that Court (170 F. (2d) 1001, 1004; R. 219) that the *Moore, Inc.* case involved section

122(d)(4) of the Internal Revenue Code, whereas here, we are concerned with section 23(g)(4). This statement overlooks completely the facts that the only issue in this case, as in the *Moore* case, is whether an adjustment is required under section 122(d)(4), and that when Congress in section 122(d)(4) used the term "capital assets" it was necessarily using that term as it is defined in sections 23(g)(4) and 117.

The Court below, in effect, concedes that if the provision in section 101 of the Revenue Act of 1942 that the amendments "shall be applicable only with respect to taxable years beginning after December 31, 1941" is interpreted as it was in the *Moore, Inc.* case to mean nothing less than "in computing a tax liability for" taxable years beginning after December 31, 1941, the position of the petitioner here would be correct. The Court stated (R. 220):

> "* * * The argument might have some merit if the words of the statute are so changed, but we are not authorized to change them, and we believe there is a substantial difference between the phrase 'with respect to' as it stands in the statute and the phrase 'in computing a tax liability for' as urged by Petitioner. It is true that in the present case we are not computing a tax liability for 1941, but if we make the 1942 Amendment applicable to the transaction in 1941 we are making it applicable 'with respect to' a transaction in the taxable year 1941 contrary to the provisions of the amendment."

The Court, without attempting to offer any interpretation of the words "with respect to" in section 101 of the Revenue Act of 1942, has attempted to write into the statute a limitation to the effect that the amendment can have no application to an event occurring prior to the effective date thereof, regardless of whether the tax liability in question is for a period prior to, or subsequent to, such effective date, and regardless of the effect which such event may have

"with respect to" the subsequent period. The fact is, however, that the statute does not refer to transactions occurring in any period. The statute directs itself *to* taxable *years*. There is nothing to indicate that Congress in any way had in mind *events* occurring *in* any particular period of time. We submit that when in a revenue statute Congress makes an amendment applicable "with respect to" a taxable year, the language, in the words of The Tax Court in the *Moore, Inc.* case, "could mean nothing less than 'in computing a tax liability for' ". It may be suggested that the words "with respect to" are not the same words as "in computing a tax liability for" and that if Congress had intended the latter, it could have so stated. The fact is that the words "with respect to" are broad and general and more inclusive than the words "in computing a tax liability for". We suggest that Congress used the broad and general words deliberately but not as an indication of intent that the amendment should not be applicable in computing tax liability for the year to which the amendment was made applicable. The use of the words "in computing a tax liability for" alone would be inadequate. The provisions of the Internal Revenue Code are not directed solely to the computations of tax liability. The essential function of the Internal Revenue Code is to provide a method for the computation of tax liability, but the Code encompasses much more. For example, it provides methods for the payment and enforcement of the tax liability (sections 51-60, 141-151), for statutes of limitations upon the assessment and refund of taxes (sections 275-277, 322), penalties for evasion of the tax (section 145) and many other related matters. It would, therefore, be inaccurate for Congress to provide that the amendments contained therein shall be applicable only in the computation of the tax liability for a particular year when such amendments relate to matters other than the mere computation of tax liability.

For example, section 136 of the Revenue Act of 1942 amended section 51 of the Internal Revenue Code to remove the requirement that individual tax returns be filed under oath and substituted therefor a requirement that there be a written declaration that the return is made under the penalties of perjury. No specific provision was made for the effective date of this amendment and it was, therefore, by the terms of section 101 of the Revenue Act of 1942 made "applicable only with respect to taxable years beginning after December 31, 1941". That amendment had nothing to do with the computation of tax liability as such. Other amendments, however, were of importance only in connection with the computation of tax liability, as for example, section 103 of the Revenue Act of 1942 amending section 12(b) of the Internal Revenue Code providing for the rates of surtax. We submit, therefore, that when Congress provides that amendments to the Internal Revenue Code "shall be applicable only with respect to taxable years beginning after" a particular date, Congress intends that the amendments shall be given the broadest possible application in connection with any matters affecting taxable years beginning after the date specified. Since some of the amendments are of importance only in connection with the computation of tax liability, the words "with respect to" must necessarily include the sense of "in computing a tax liability for"; although the words "with respect to" can, and should, be interpreted as encompassing more than a mere "in computing a tax liability for", such words cannot properly be given a meaning excluding "in the computation of tax liability for".

A further and more fundamental objection to the reasoning of the Court below that the petitioner's position would require making the 1942 amendment applicable to a transaction occurring in the year 1941 is that the Court miscon-

ceived the basic issue in the case. There actually is no problem of making the 1942 amendment applicable to a 1941 transaction. The only question is whether the loss which the petitioner sustained on the worthlessness, in 1941, of the stock of Reo Sales Corporation must be eliminated in computing the amount of the net loss deduction allowable for the year 1942. As has been previously pointed out, section 122(d)(4) applicable to the year 1942 provides that losses on the sales of "capital assets" shall be eliminated. The 1942 law does not include stock in an affiliated company as a capital asset. Therefore, there is nothing in the law applicable to 1942 which provides that the loss on the worthlessness of the Reo Sales Corporation stock shall be eliminated in computing the net loss deduction allowable for 1942. The fact that the 1942 law states that a particular loss need not be eliminated in computing the net loss deduction for 1942 does not make the 1942 amendment in any way retroactive or applicable "with respect to" transactions in a prior year. The sole and only purpose of the whole of subsection (d) of section 122 is to set forth "the exceptions, additions and limitations" required to be made in arriving at the amount of a net operating loss deduction to be allowed. It does not affect, in any way, the manner or extent to which a transaction shall be reflected in the computation of a prior year's net income; it merely provides the extent to which the gain or loss, or other tax result of the particular transaction, shall be excepted, added or limited, in computing the current year's net operating loss deduction. We submit that the 1942 law in providing that a gain or loss occurring in 1941 shall be excepted and eliminated, or added, or limited in any way in computing a deduction for 1942 and, therefore, the tax liability "with respect to" the year 1942 does not, in any way, involve the question of retroactivity or being made applicable "with respect to" any prior year. Any law which provides for

the allowance of a net loss deduction of necessity must refer to the events of a prior taxable period. Certainly, a statute which provides that a net loss deduction shall be allowed for the year 1942 is not, therefore, automatically a retroactive statute. A statute adopted in 1942, providing for the allowance of a deduction in 1942, and made applicable only to the computation of 1942 and subsequent years tax liabilities cannot, we submit, be considered as in any way having a retroactive application, nor can a statute be considered as retroactive which provides the manner of the computation of a deduction to be allowed in the current and subsequent years.

The Court below argues (R. 221) that if Congress had intended the result for which the petitioner contends "Congress could have given section 23(g)(4) retroactive application by expressly providing that it should be applicable to transactions in preceding years in cases where a tax liability was being computed for taxable years beginning after December 31, 1941, involving transactions in such prior years". Of course, Congress could have used the words suggested. Also, it could, instead of the broad and general words "with respect to", have used the specific words necessary to make it clear in exactly what sense the amendments effected by sections 102 and 103 of the Revenue Act of 1942 dealing with tax rates, section 136(a) dealing with the signing of returns, section 136(b) dealing with penalties or any other section should be applicable "with respect to taxable years beginning after December 31, 1941". That Congress believed that the words suggested by the Court below were unnecessary and were included in the broad and general term is demonstrated by the Report of the Senate Finance Committee (Senate Report No. 1631, 77th Congress, Second Session) (discussed *supra*, p. 26). Here again, the Court below overlooked the fact that the only

question in this case is whether the 1942 law provides that a particular loss shall be eliminated in computing the 1942 net operating loss deduction, and that there is actually no question of retroactivity involved.

The Court below suggests (R.-220) that the interpretation urged by the petitioner, and adopted by both The Tax Court of the United States and the United States Court of Appeals for the Fifth Circuit in the *Moore, Inc.* case, would make the 1942 amendment applicable "with respect to" a transaction in the taxable year 1941. The petitioner does not contend, and never has contended, that the 1942 amendment could in any way affect the manner or the extent to which the 1941 transaction was to affect its 1941 tax liability. The petitioner does contend, however, that the question whether a loss on a transaction occurring in 1941 shall be eliminated in computing the net operating loss deduction in its 1942 tax return must be determined under the law specifically made applicable "with respect to" the taxable year 1942.

Conclusion.

We submit that the judgment of the Court below should be reversed.

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APPENDIX A.

Statutes Cited.

Internal Revenue Code (Title 26, United States Code).

Section 21.

Net Income.

(a) *Definition.*—"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

(b) *Cross References.*—For definition of "Adjusted net income" and "normal-tax net income," see section 13.

Section 23(s).

Deductions from gross income.

In computing net income there shall be allowed as deductions:

* * * * * * *

(s) *Net operating loss deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

Section 44(a).

Installment Basis.

(a) *Dealers in Personal Property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

Section 113(a)(5).

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * * * *

(5) *Property Transmitted at Death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. In the case of property transferred in trust to pay the income for life ~~to~~ or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death. For the purpose of this paragraph property passing without full and adequate consideration under a general power of appointment exercised by will shall be deemed to be property passing from the individual exercising such power by bequest or devise. If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, and if the decedent died after August 26, 1937, and if the property consists of stock or securities of a foreign corporation, which with respect to its taxable year next preceding the date of the decedent's death was, under the law applicable to such year, a foreign personal holding company, then the basis shall be the fair market value of such property ~~at~~ the time of such acquisition or the basis in the hands of the decedent, whichever is lower. In the case of an election made by the executor under section 811(j), the time of acquisition of the property shall,

for the purpose of this paragraph, be the applicable valuation date of the property prescribed by such section in determining the value of the gross estate. For the purposes of this paragraph the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any State, Territory or possession of the United States or any foreign country shall be considered to be property "acquired by bequest, devise, or inheritance" from the decedent, if the death of the decedent was after December 31, 1947, and if at least one-half of the whole of the community interest in such property was includible in determining the value of the decedent's gross estate under section 811. In the case of property held by a decedent and his surviving spouse under the community property laws of any State, Territory, or possession of the United States or any foreign country, if the value of any part of the surviving spouse's one-half share of such property was included in determining the value of the gross estate of the decedent and a tax under chapter 3 was payable upon the transfer of the net estate of the decedent, then for the purposes of this paragraph such part of such one-half share of the surviving spouse shall be considered to be property "acquired by bequest, devise, or inheritance" from the decedent, if the death of the decedent was after the date of the enactment of the Revenue Act of 1942 and on or before December 31, 1947; but nothing in this sentence shall reduce basis below that which would exist if the Revenue Act of 1948 had not been enacted.

Section 113(a)(6).

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * * *

(6) *Tax-free Exchanges Generally.*—If the property was acquired, after February 28, 1913, upon an exchange described in section 112(b) to (e), inclusive, or section 112(l), the basis (except as provided in paragraphs (15), (17), or (18) of this subsection) shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112(b) or section 112(l) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. Where as part of the consideration to the taxpayer another party to the exchange assumed a liability of the taxpayer or acquired from the taxpayer property subject to a liability, such assumption or acquisition (in the amount of the liability) shall, for the purposes of this paragraph, be considered as money received by the taxpayer upon the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

Section 113(a)(7).

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * * *

(7) *Transfers to Corporation.*—If the property was acquired—

(A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or

(B) in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

Section 113(a)(8).

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * * *

(8) *Property Acquired by Issuance of Stock or as Paid-In Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112(b)(5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

Section 113~~(a)~~ ~~(9)~~.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * * *

(9) *Involuntary Conversion.*—If the property was acquired, after February 28, 1913, as the result of a compulsory or involuntary conversion, described in section 112(f), the basis shall be the same as in the case of the property so converted, decreased in the amount of any ~~money~~ received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made.

Section 117(a)(1). (As that section applied to the taxable year 1941.)

Capital gains and losses.

(a) *Definitions.*—As used in this chapter—

(1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

Section 117(a)(5). (As that section applied to the taxable year 1941.)

(a) *Definitions.*—As used in this chapter—

* * * * * *

(5) *Long-term capital loss.*—The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such loss is taken into account in computing net income.

Section 117(b). (Prior to amendment by section 150(c) of the Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session) and as it applied to the taxable year 1941.)

Capital gains and losses.

* * * * * *

(b) *Percentage taken into account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 18 months;

66⅔ per centum if the capital asset has been held for more than 18 months but not for more than 24 months;

50 per centum if the capital asset has been held for more than 24 months.

Section 117(b). (After amendment by section 150(c) of the Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session) and as it applied to the taxable year 1942.)

Capital gains and losses.

* * * * * *

(b) *Percentage taken into account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

Section 117(j).

Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business—

(1) *Definition of Property Used in the Trade or Business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k)(1) or (2) is applicable.

(2) *General Rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets ~~held for~~ more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of

capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

Section 122(a). (As it read prior to amendment by section 105(e)(3)(A) of the Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session) and as it applied to the taxable year 1941.)

Net operating loss deduction.

(a) *Definition of net operating loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions and limitations provided in subsection (d).

Section 122(a). (As amended by section 105(e)(3)(A) of the Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session) and as it applied to the taxable year 1942.)

Net operating loss deduction.

(a) *Definition of net operating loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions and limitations provided in subsection (d).

Section 122(b). (As it read prior to amendment by section 153(a) of the Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session).)

(b) *Amount of carry-over.*—The term "net operating loss carry-over" means in the case of any taxable year the sum of:

(1) The amount, if any, of the net operating loss for the first preceding taxable year; and

(2) The amount of the net operating loss, if any, for the second preceding taxable year reduced by the excess, if any, of the net income (computed with the exceptions and limitations provided in subsection (d)(1), (2), (3), and (4)) for the first preceding taxable year over the net operating loss for the third preceding taxable year.

Section 122(b). (As it read after amendment by section 153(a) of the Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session) and as it applied both to the taxable year 1941 and to the taxable year 1942.)

(b) *Amount of carry-back and carry-over.*—

(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back

in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d)(1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(2) *Net operating loss carry-over.*—If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d)(1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d)(1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year).

Section 122(c). (As it read prior to amendment by sections 105(e)(3)(B) and 153(b), Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session).)

Amount of net operating loss deduction.—The amount of the net operating loss deduction shall be the amount of the net operating loss carry-over reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d)(1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction).

Section 122(c). (As amended by section 153(b), Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session), and as it applied to the taxable year 1941.)

Amount of net operating loss deduction.—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d)(1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal tax net income (computed without such deduction).

Section 122(c). (As amended by sections 105(e)(3)(B) and 153(b), Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session), and as it applied to the taxable year 1942.)

Amount of net operating loss deduction.—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year

reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d)(1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 23(e)).

Section 122(d)(1). (Prior to amendment by section 105(e)(3)(C), Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session), and as it applied to the taxable year 1941.)

(d) *Exceptions and limitations.*—The exceptions and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114(b)(2), (3), or (4).

Section 122(d)(1). (After amendment by section 105(e)(3)(C), Revenue Act of 1942 (Public Law No. 753, 77th Congress, 2nd Session), and as it applied to the taxable year 1942.)

(d) *Exceptions, additions, and limitations.*—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114(b)(2), (3), or (4).

Section 122(d)(2). (Prior to amendment by section 105(e)(3)(C), Revenue Act of 1942 and as it applied to the taxable year 1941.)

(d) *Exceptions and Limitations.*—The exceptions and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23(b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax exempt obligations.

Section 122(d)(2). (After amendment by section 105(e)(3)(C), Revenue Act of 1942 and as it applied to the taxable year 1942.)

(d) *Exceptions, Additions and Limitations.*—The exceptions, additions and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23(b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax exempt obligations.

Section 122(d)(3). (Prior to amendment by section 105(e)(3)(C), Revenue Act of 1942 and as it applied to the taxable year 1941.)

(d) *Exceptions and Limitations.*—The exceptions and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(3) No net operating loss deduction shall be allowed.

Section 122(d)(3). (As amended by section 105(e)(3)(C), Revenue Act of 1942 and as it applied to the taxable year 1942.)

(d) *Exceptions, Additions and Limitations.*—The exceptions, additions and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(3) No net operating loss deduction shall be allowed.

Section 122(d)(4). (Prior to amendment by section 105(e)(3)(C), and section 150(e) of the Revenue Act of 1942 and as it applied to the taxable year 1941.)

(d) *Exceptions and Limitations.*—The exceptions and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(4) Long-term capital gains and long-term capital losses shall be taken into account without regard to the provisions of section 117(b). As so computed the amount deductible on account of long-term capital losses shall not exceed the amount includible on account of long-term capital gains, and the amount deductible on account of short-term capital losses shall not exceed the amount includible on account of short-term capital gains.

Section 122(d)(4). (After amendment by section 105(e)(3)(C) and section 150(e) of the Revenue Act of 1942 and as it applied to the taxable year 1942.)

(d) *Exceptions, Additions and Limitations.*—The exceptions, additions and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(4) Gains and losses from sales or exchanges of capital assets shall be taken into account without regard to

the provisions of section 117(b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains.

Section 122(d)(5). (Prior to amendment by section 105(e)(3)(C), Revenue Act of 1942 and as it applied to the taxable year 1941.)

(d) *Exceptions and Limitations.*—The exceptions and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions and limitations specified in paragraphs (1) to (4) of this subsection.

Section 122(d)(5). (After amendment by section 105(e)(3)(C), Revenue Act of 1942 and as it applied to the taxable year 1942.)

(d) *Exceptions, Additions and Limitations.*—The exceptions, additions and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be com-

puted with the exceptions, additions and limitations specified in paragraphs (1) to (4) of this subsection.

Section 122(d)(6). (After amendment by section 105(e)(3)(C), Revenue Act of 1942 and as it applied to the taxable year 1942.)

(d) *Exceptions, Additions and Limitations.*—The exceptions, additions and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(6) There shall be allowed as a deduction the amount of tax imposed by subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

Section 122(e). (Prior to amendment by section 153(c), Revenue Act of 1942.)

No carry over from year prior to 1939.—As used in this section, the terms "third preceding taxable year", "second preceding taxable year", and "first preceding taxable year" do not include any taxable year beginning prior to January 1, 1939.

Section 122(e). (After amendment by section 153(c), Revenue Act of 1942 and as it applied to the taxable years 1941 and 1942.)

No carry back to year prior to 1941.—As used in this section, the term "preceding taxable year", and the term "preceding taxable years" do not include any taxable year beginning prior to January 1, 1941.

Title 28, United States Code (Public Law 773, 80th Congress, Chapter 646, 2nd Session).

Section 1254.

Courts of appeals; certiorari; appeal; certified questions

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment of decree;

(2) By appeal by a party relying on a state statute held by a court of appeals to be invalid as repugnant to the Constitution, treaties or laws of the United States, but such appeal shall preclude review by writ of certiorari at the instance of such appellant, and the review on appeal shall be restricted to the Federal questions presented;

(3) By certification at any time by a court of appeals of any question of law in any civil or criminal case as to which instructions are desired, and upon such certification the Supreme Court may give binding instructions or require the entire record to be sent up for decision of the entire matter in controversy.

APPENDIX B.

Section 29.117-7, Regulations 111.

Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business.—Section 117(j) provides that the recognized gains and losses

(a) from the sale, exchange, or involuntary conversion of property used in the trade or business of the taxpayer at the time of the sale, exchange, or involuntary conversion, held for more than six months, which is

(1) of a character subject to the allowance for depreciation provided in section 23(l), or

(2) real property,

provided that such property is not of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or is not held by the taxpayer primarily for sale to customers in the ordinary course of trade or business, and

(b) From the involuntary conversion of capital assets held for more than six months, and

(c) From timber held for more than six months which is considered to have been sold under the provisions of section 117(k)(2), and with respect to taxable years beginning after December 31, 1943, from timber owned or held under a contract right to cut for more than six months prior to the beginning of the taxable year which is considered to have been sold or exchanged under the provisions of section 117(k)(1), regardless of whether such timber would be properly includible in the inventory of the taxpayer if on hand at the close of

the taxable year or whether such timber was held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business,

shall be treated as gains and losses from the sale or exchange of capital assets held for more than 6 months if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets.

In determining whether such gains exceed such losses for the purposes of section 117(j), losses upon the destruction in whole or in part, theft or seizure, requisition or condemnation of the property described in section 117(j) are included whether or not there was a conversion of such property into money or other property. For example, if a capital asset held for more than 6 months, with an adjusted basis of $400, is stolen, and the loss from this theft is not compensated for by insurance or otherwise, the $400 loss is included in the computations under section 117(j) to determine whether gains exceed losses. Furthermore, in making this computation, the gains and losses described in section 117(j) are taken into account without regard to the percentage provisions of section 117(b), that is, 100 percent of such gains and losses is taken into account. For example, if a taxpayer sustains a loss of $400 upon the sale under threat of condemnation of a capital asset, held for more than 6 months, such loss is taken into account for the purposes of section 117(j) to the extent of $400, even though only $200 would be taken into account under section 117(b) in computing net income. Similarly, the provisions of section 117(d) limiting the deduction of capital losses are not applicable to exclude any losses from the computations under section 117(j). With these exceptions as to sections

117(b) and 117(d), gains and losses are included in the computations under section 117(j) only to the extent that they are taken into account in computing net income. Thus, losses which are not deductible items under section 24 or section 118 are not included in the computations under section 117(j). Similarly, if a taxpayer reports on the installment basis under section 44 the gain on the sale of property described in section 117(j), only the portion of the gain reported under section 44 in computing net income for the taxable year is included in the computations for such taxable year under section 117(j). Any gains and losses which are not recognized under section 112 are not included in the computations under section 117(j). Thus, if property is involuntarily converted into similar property, so that the gain on such conversion is not recognized under the provisions of section 112(f), such gain is not included in the computations under section 117(j).

If it is determined under the above computations that the gains exceed the losses, all of such gains and losses are treated as gains and losses from the sale or exchange of capital assets held for more than 6 months. All such gains and losses are then subject to the limitations of section 117(b), (c), and (d), relating to the percentage taken into account, the alternative tax in the case of capital gains and losses, and the extent to which capital losses are allowed. If it is determined under the above computations that the gains do not exceed the losses, none of such gains and losses are treated as gains and losses from the sale or exchange of capital assets. Such gains and losses are then not subject to the percentage limitations of section 117(b), and such losses are not subject to the limitations provided in section 117(d). For example, if the taxpayer during the taxable year has losses of $1,000 on the sale of certain depreciable machinery used in his trade or business, held for more than

6 months, and a gain of $400 on the sale under threat of condemnation of a capital asset held for more than 6 months, such losses exceed such gain, and such losses and gain are not treated as losses and gain from the sale or exchange of capital assets. The gain on the sale of the capital asset would therefore be taken into account in full, instead of to the extent of 50 percent as provided in section 117(b).

Section 117(j) does not apply to gains and losses on the sale, exchange, or involuntary conversion of any property which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or which is held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, but not including as such property timber which is considered to have been sold or exchanged as provided in section 117(k)(1) or which has been sold as provided in section 117(k)(2). The involuntary conversion of property described in section 117(j) is the conversion of such property into money or other property as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof.

The following examples will illustrate the operation of the provisions of section 117(j):

Example (1). A, an individual, makes his income tax return on the calendar year basis. A's recognized gains and losses for 1942 of the kind described in section 117(j), computed without regard to the limitations in section 117(b), are as follows:

	Gains	*Losses*
1. Gain on sale of machinery, used in the business and subject to an allowance for depreciation, held for more than six months	$ 4,000	

	Gains	*Losses*
2. Gain reported in 1942 (under section 44) on installment sale in 1941 of factory premises used in the business (including building and land, each held for more than six months)	$ 6,000	
3. Gain reported in 1942 (under section 44) on installment sale in 1942 of land held for more than six months, used in the business as a storage lot for trucks	2,000	
4. Gain on proceeds from requisition by Government of boat, held for more than six months, used in the business and subject to an allowance for depreciation	500	
5. Loss upon the destruction by fire of warehouse, held for more than six months and used in the business (excess of adjusted basis of warehouse over compensation by insurance, etc.)		$3,000
6. Loss upon theft of unregistered bearer bonds, held for more than six months		5,000
7. Loss in storm of pleasure yacht, purchased in 1940 for $1,800 and having a fair market value of $1,000 at the time of the storm		1,000
8. Total gains	$12,500	
9. Total losses		$9,000
10. Excess of gains over losses	3,500	

Since the aggregate of the respective recognized gains ($12,500) exceeds the aggregate of such losses ($9,000), such gains and losses are treated under section 117(j) as gains and losses from the sale or exchange of capital assets held for more than six months. Therefore, under the provisions of section 117(b), A will take into account only 50 percent of the amounts of items 1 to 7. Such items are treated the same as any other long-term gains and losses of A, and will cause the inclusion of $1,750 (50 percent of item 10) in computing his net long-term capital gain for the purposes of the alternative tax provided by section 117(c)(2).

Example (2). A's yacht, used for pleasure and acquired for such use in 1935 at a cost of $25,000, was requisitioned by the Government in 1942 for $15,000. A sustained no deductible loss, and no loss with respect to such requisition will be included in the computations under section 117(j).

Example (3). If in example (1) the taxpayer were a corporation, then there would be taken into account 100 percent of the gains and losses in items 1 to 7, which are treated for all purposes as gains and losses from the sale or exchange of capital assets held for more than six months. The percentage provisions of section 117(b) do not apply to corporations. These items will cause the inclusion of $3,500 (item 10) in computing the net long-term capital gain of the corporation for the purposes of the alternative tax provided by section 117(c)(1).

Example (4). If in example (1) A also had a loss of $4,000 from the sale under threat of condemnation of a capital asset held for more than six months, then the gains ($12,500) would not exceed the losses ($9,000 + $4,000, or $13,000). Neither the loss on such sale of a capital asset

nor any of the other items set forth in example (1) would then be treated as gains and losses from the sale or exchange of capital assets, but all of such items would be treated as ordinary gains and losses. Since all of such items are included in full in computing net income, the net effect of such items will be the inclusion in computing net income of a loss of $500 (the excess of the $13,000 losses over the $12,500 gains). This same result would be obtained if A were a corporation. If the loss on the sale of the capital asset under threat of condemnation were $3,500, the gains and losses would still be treated as ordinary gains and losses and not as capital gains and losses, since the gains ($12,500) would not exceed the losses ($9,000 + $3,500, or $12,500).